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TAGS: [CE](#) [EAGR](#) [ECON](#) [ETRD](#) [PGOV](#)
SUBJECT: SRI LANKA,S ECONOMIC POLICY FOCUSES ON GOVERNMENT
LED DEVELOPMENT; SEES FUTURE IN ASIA

REF: COLOMBO 1040

Classified By: ACTING DEPUTY CHIEF OF MISSION MICHAEL PERKINS FOR REASO
NS 1.4 (B,D)

¶1. (C) Summary. The Government of Sri Lanka (GSL) has adopted a hybrid economic model based on government led development, private sector exports, agricultural self sufficiency, large infrastructure projects and focusing on Asia instead of the United States or Europe. Sri Lanka has an historic opportunity to rapidly develop its economy with the end of the war, and has big plans to reconstruct the conflict damaged North and East of the country. Although the GSL strategy envisions a role for the private sector, the government will direct economic development. Sri Lanka plans to increase exports, but also embraces an import substitution model for agriculture and energy. Stung by Western criticism of their handling of the end of the war, top Sri Lankan officials are looking to Asia for their economic future. End Summary.

The Opportunity of a Lifetime

¶2. (U) Following the end of the 30 year civil war, Sri Lanka has an historic opportunity to jump to a high growth path that will enrich her people. Sri Lanka averaged 5% GDP growth for the last 20 years, despite the civil war that drained the government revenues, destroyed infrastructure, and scared off potential investors and tourists. Sri Lanka should benefit from the economic reintegration of the country, which will open fertile agricultural areas in the East to cultivation. Sri Lanka should also reap increased foreign investment now that armed conflict has ended and uncertainties have subsided. Treasury Secretary P.B. Jayasundera, Sri Lanka,s foremost economic strategist, points out that Sri Lanka raised its per capita GDP from \$1,000 USD in 2004 to \$2,000 today. The GSL,s goal is to raise GDP growth rates to well over 8% to enable Sri Lanka to achieve a per capita income of \$5,000 by 2019. The GSL has ambitious plans to reconstruct the North and East that could cost over \$2 billion, financed in part, Sri Lanka hopes, by donors.

Government Led Economic Development Model

¶3. (C) A well connected academic (who reportedly speaks regularly with President Rajapaksa) said that under the GSL economic model, the government steers the boat and the private sector paddles. An international financial organization official explained that the GSL wants to engage

with the private sector, but since they do not trust private business, the GSL sometimes undercuts the private sector. The GSL publically endorses a liberal trade regime, but maintains high tariffs on many items (often with an effective rate over 100%), and focuses on increasing exports, not opening the domestic market to competition. The GSL plans to designate specific industries for promotion and to speed their development through incentives. Various contacts have told econoff that Sri Lanka does not see any particular country as its economic model, but rather it is developing a new Sri Lanka model of economic growth. That said, top GSL officials are impressed by China and other Asian models, and they see Sri Lanka's economic future connected to Asia, not the West. Finally, despite the overarching rhetoric, Sri Lanka's economic model is often trumped by short term political concerns, so many decisions are ad hoc.

Sri Lankan Economic Priorities Start with Agriculture

¶4. (C) President Rajapaksa's first economic priority is agricultural self sufficiency. The President and his powerful brothers (reftel A) hail from landowners in the South, and they idealize the farmer. In an interview with Forbes Magazine, President Rajapaksa said 'I prefer (that the Sri Lanka economic model) to be agriculturally based. If you can be self sufficient in food, then the industries will come'. The GSL has instituted policies to protect agricultural production. The GSL owns 82% of the land, although the land is used by companies and individuals under long term leases. The GSL does not permit land used for rice farming to be converted to other uses. In addition, a

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private banking official told econoff that banks must lend at least 10% of their loans for agricultural clients. Although the GSL supports fruit and vegetable exports, its trade policy encourages production of basic food crops such as rice. The GSL economic policy is encapsulated in President Mahinda Rajapaksa's campaign manifesto Mahinda Chintana ('Mahinda's Thoughts'). Mahinda Chintana states that 'it is unlikely that liberalized trade policies alone will facilitate mobilization and allocation of the poor farmers, resources in economically advantageous sectors. Therefore, a liberal trade regime is to be supported by adequate safeguard measures to provide a stable trade regime'.

¶5. (SBU) In addition to agriculture, the GSL economic plan features large infrastructure projects, tourism, ports, and professional services. The GSL touts road construction in its development plans, and rightly so. Sri Lankan roads are in such poor condition that Sri Lanka farmers lose 40% of their agricultural production to spoilage and tourists find it long and cumbersome to get around the island. The GSL projects that tourism will increase from 500,000 per year now to 2.5 million by 2016. Sri Lanka does have real tourist potential, although it still must build many new hotels and develop properly trained staff. Sri Lanka also aspires to be a transportation hub through a strong port sector. Finally, Sri Lanka has plans to develop business operations outsourcing, with a small information technology industry.

¶6. (C) Although the economic sectors selected by the GSL make sense, it is unclear if the GSL can successfully direct the economy to its development goals. Many well connected business leaders praise Treasury Secretary P.B. Jayasundera as someone who can get things done. In contrast, an American economist with experience in Sri Lanka, commented that Jayasundera is an economic nationalist who did not know what business needed. Instead, the economist observed, the GSL focuses on huge infrastructure projects which may not be viable economically. Similarly, an opposition-affiliated economist described GSL decision making as populist and influenced by the well connected. A good example is the port sector, where the government is simultaneously building a huge addition to the Port of Colombo and an enormous Chinese financed port in Hambantota, in President Rajapaksa's home

region. Both ports will depend on Indian cargo transshipment, but private industry officials doubt if there will be enough trade to go around. In any case, the Hambantota project is a huge deliverable to the President, his home region and his electoral base.

The Import Substitution Model Still Lives in Sri Lanka

17. (C) Reaching back to the 1970s, Jayasundera endorses an import substitution model for the agricultural and energy sectors. In a newspaper interview, Jayasundera explained that the GSL economic strategy planned 'to strengthen the indigenous economy by substituting the import economy with a production economy. The first step is to provide protection to local entrepreneurs from unnecessary foreign competition. That is why taxes were levied on certain imported items. We should create a profitable environment for local farmers. If not, they will give up agriculture'. Jayasundera made the same argument in a briefing for local business leaders, arguing that the GSL should encourage import substitution for agriculture (for food security) and energy (for lower electrical costs). In energy, the GSL is building several large coal fired electrical plants, one with massive Chinese assistance, to replace oil fired electrical plants. Ironically, both oil and coal are imported, so Sri Lanka will not be energy independent, but the GSL hopes to reduce energy import costs with coal. Sri Lanka has a Presidential Commission to reform its tax laws, and Jayasundera told the business leaders that the new tax system would safeguard agriculture and domestic value added industries. Jayasundera also warned the business leaders that Sri Lanka was ready to take off, with or without investors, and closed with a patriotic appeal for business leaders to invest domestically first, and outside only later.

Sri Lanka Turns to Asia

18. (C) Sri Lanka increasingly sees its economic future with Asia instead of the United States and the West.

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Jayasundera told the business leaders that economic strength and political clout were shifting from the U.S. and European Union to Asia. Moreover, Asia will be the driving force in world economic growth, and its economic development has not been accomplished, he judged, according to traditional Western economic models. Several contacts have said that Sri Lanka has been frustrated with Western human rights criticism following the end of the war, turning them to China and other Asian countries. A knowledgeable Western academic related that President Rajapaksa was enamored with China and the Chinese model. Sri Lanka is also receiving large donations from Asia. The Sri Lankan Central Bank forecast that for project donations in 2009 and 2010, Sri Lanka would receive 46% of its donations from China and 17% from Japan, with the Western affiliated World Bank (14%) and the Asian Development Bank (12%) trailing. (Note. The Central Bank presentation apparently did not consider humanitarian assistance, and U.S. project development aid is lumped with 'others' at 7%. End Note.) Finally, some GSL officials are going further afield. Several senior business leaders spoke to GSL officials after their official trip to Myanmar. They reported with concern to econoff that several GSL officials spoke approvingly of Myanmar, its supposed economic successes and saw Myanmar as a potential economic model.

19. (C) Comment. In post, his view, some of the GSL stated desire to turn its attention toward Asia is overblown, because Sri Lanka's principal export markets remain the United States and Europe, and economic policymakers know that. The GSL genuinely wants to attract foreign investment and increase its exports, which they understand is crucial to increase employment opportunities. There have been no moves to restrict the private sector, and many business leaders are well connected and influential. That said, the GSL has taken steps to increase import duties and otherwise protect its

domestic market and producers, indicating a mercantilist approach to international trade. The Rajapaksa government believes in promoting agricultural self sufficiency by protecting local farmers, people who also happened to be their political base. Post expects that Sri Lanka,s economy will improve after the war since some sectors such as tourism are can,t miss, but their inward looking economic policy is likely to prevent them from realizing their full economic potential. End Comment.
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